

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF ALABAMA

In re

Case No. 01-06689-DHW
Chapter 7

JAMES D. THOMAS
GEORGIANA P. THOMAS,

Debtors.

WILLIAM C. CARN, III, Trustee,

Plaintiff,

v.

Adv. Proc. No. 02-1013-DHW

BRANTLEY TUDOR and
TRUDY TUDOR,

Defendants.

MEMORANDUM OPINION

The chapter 7 trustee filed a complaint under 11 U.S.C. § 547 to avoid an alleged preferential transfer of an interest in real property.

A trial on the complaint was held June 11, 2003. The court took the adversary proceeding under advisement based on the evidence and stipulations of the parties.

Jurisdiction

The court has jurisdiction in this adversary proceeding pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(F) in which the court may enter a final judgment.

Undisputed Facts

Brantley and Trudy Tudor are friends of the debtors James D. and Georgiana P. Thomas. The Tudors made a \$30,000 loan to the debtors in November 2000 to enable them to purchase a parcel of real property in Barbour County, Alabama in December 2000 or January 2001.

In exchange for the loan, the debtors promised to execute and record a note and second mortgage on the property in favor of the Tudors. The debtors did not in fact execute the note and second mortgage until July 26, 2001 — over 8 months after receiving the loan proceeds.

The debtors attribute the delay to the critical illness of Mr. Thomas and sheer procrastination. During the months following the loan, the Tudors asked, but did not press, the debtors to issue the note and mortgage.¹ The debtors responded with assurances. The Tudors relied on the assurances of the debtors.

Neither the debtors nor the Tudors recorded the mortgage in July 2001. The debtors recorded the mortgage in the Probate Court of Barbour County, Alabama in October 9, 2001 – fifteen days before the debtors filed a chapter 7 bankruptcy case on October 24, 2001.

The trustee filed the instant complaint under 11 U.S.C. § 547 to avoid the transfer made by the recording of the mortgage.²

¹ The Tudors lived in North Carolina and the debtors in Alabama. They communicated primarily via the internet.

² The trustee sold the real property described in the mortgage after reaching an agreement with the Tudors to hold the sale proceeds in the trustee's account subject to the court's determination in this adversary proceeding.

Contentions of the Defendants

The Tudors do not contest that the elements of a preferential transfer under 11 U.S.C. § 547(b) are met. The Tudors contend instead the following: (1) the real property is subject to a constructive trust in favor of the Tudors; (2) the real property is subject to an equitable mortgage in favor of the Tudors.

Conclusions of Law Constructive Trust

The Tudors first contend that the debtors hold the real property subject to a constructive trust in favor of the Tudors. The court disagrees.

A constructive trust “is a creature of equity that operates to prevent unjust enrichment.” *In re Poffenbarger*, 281 B.R. 379, 388 (Bankr. S.D. Ala. 2002). The Alabama Supreme Court has adopted the following quote:

‘Equity may impress a constructive trust on property in favor of one beneficially entitled thereto when another holds title to the property by fraud, commission of wrong, abuse of a confidential relationship, or any other form of unconscionable conduct. Equity may also impress a constructive trust on property in favor of one beneficially entitled thereto against a person, who, against the rules of equity and against good conscience, in any way either has obtained or holds and enjoys legal title to property that in justice that person ought not to hold and enjoy.’

Brown v. Brown, 604 So. 2d 365, 370 (Ala. 1992) (citations and emphasis omitted). In other words, “[w]hen property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.” *Id.* (citation omitted).

In the instant case, the debtors did not acquire the loan or the real property “by fraud, commission of wrong, abuse of a confidential relationship, or any other form of unconscionable conduct.” *Id.* Nor was the property “acquired in such circumstances” that the debtors should not “in good conscience retain the beneficial interest.” *Id.*

The Tudors voluntarily loaned the debtors \$30,000 to enable them to purchase the real property. The debtors in fact used the money for that purpose. The debtors promised to execute and record a note and mortgage on the property; the debtors did just that. The delay resulted from both procrastination and circumstances beyond the debtors’ control.

The Tudors did nothing to assist the preparation or recording of the instruments. Neither did the Tudors attempt to force compliance — either by insistence or legal remedy. The parties were friends who were willing to trust one another. Were it not for the intervention of bankruptcy, the Tudors would have a perfected second mortgage on the property.

Under these circumstances, the court does not conclude that the debtors either acquired or held the property “against the rules of equity and against good conscience.” *Id.* Therefore, the court concludes that the real property is not subject to a constructive trust in favor of the Tudors.

Equitable Mortgage

The Tudors also contend that the real property is subject to an equitable mortgage in favor of the Tudors. To establish an equitable mortgage, the Tudors must show that:

(1) the mortgagor has a mortgageable interest in the property sought to be charged as security; (2) a definite debt is due from the mortgagor to the mortgagee; and (3) the intent of the parties is to secure the debt by mortgage, lien, or charge on the property. *Murphy v. Carrigan*, 270 Ala. 87, 91, 116 So.2d 568 (1959); *Barnett v. Waddell*, 248 Ala. 189, 194, 27 So.2d 1

(1946); *Jones v. Stollenwerck*, 218 Ala. 637, 119 So. 844 (1928).

Hall v. Livesay, 473 So. 2d 493, 494 (Ala. 1985). The debtors have not proved the third element.³

First, there is no evidence that the parties intended to encumber the real property apart from a written instrument. The Tudors requested, and the debtors promised, to execute and record a written mortgage. Brantley Tudor is an experienced businessman and understood the importance of a written instrument. See *Baxter v. SouthTrust Bank*, 584 So. 2d 801 (Ala. 1991).

Second, the debtors executed the mortgage as promised, and the Tudors in fact acquired a legal, written mortgage on the real property as of July 26, 2001, which mortgage is fully enforceable between the debtors and the Tudors.

However, even if the parties intended to create an equitable mortgage on the property, the Tudors have not provided any law to support the priority of an equitable mortgagee over the interests of the chapter 7 trustee.

11 U.S.C. § 544 empowers a chapter 7 trustee to avoid a creditor's lien that was not properly perfected at the commencement of the case. *Patterson v. Spradlin*, 185 B.R. 354, 357 (Bankr. N.D. Ala. 1995).⁴ It is undisputed that the Tudors took no action to record either their so-called

³ The court also notes that at the time of the loan, the debtors did not have a mortgageable interest in the property. The debtors used the loan proceeds to purchase the property one or two months later.

⁴ 11 U.S.C. § 544 grants the trustee the status of a hypothetical lien creditor of the debtor, "who as of the commencement of the case, had completed the legal (or equitable) processes for perfection of a lien upon all property of the debtor available for the satisfaction of his claim against the debtor." *Spradlin*, 185 B.R. at 357.

equitable mortgage or their written mortgage. Both are covered by the Alabama's recording statute. See *Ala. Code* 35-4-90(a) (1975);⁵ *Baxter v. SouthTrust Bank*, 584 So. 2d 801 (Ala. 1991); *Wright v. Martin*, 107 So. 818, 820, 214 Ala. 334 (Ala. 1926); *Barnett v. Waddell*, 27 So. 2d 1, 6 (Ala. 1946). Both are subordinate to the trustee's interest under 11 U.S.C. § 544.⁶

A separate order will enter avoiding the transfer under 11 U.S.C. § 547.

Done this the 22nd day of August, 2003.

/s/ Dwight H. Williams, Jr.
United States Bankruptcy Judge

c: William C. Carn, III, Trustee
D. Lewis Terry, Jr., Attorney for Defendants

⁵ The recording statute in Alabama is very broad and includes all conveyances of real property:

All conveyances of real property, deeds, mortgages, deeds of trust or instruments in the nature of mortgages to secure any debts are inoperative and void as to purchasers for a valuable consideration, mortgagees and judgment creditors without notice, unless the same have been recorded before the accrual of the right of such purchasers, mortgagees or judgment creditors.

Ala. Code 35-4-90(a) (1975). The conveyances must be recorded in the office of the judge of probate. *Ala. Code* § 35-4-50 (1975).

⁶ See *Midlantic National Bank v. Bridge (In re Bridge)*, 18 F.3d 195 (3d Cir. 1994)(recording statute similar to Alabama's).